

**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554**

In the Matter of	)	
	)	
Federal-State Joint Board on	)	CC Docket No. 96-45
Universal Service	)	

**REPLY COMMENTS OF SBC COMMUNICATIONS INC.**

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Its Attorneys

## Summary

SBC Communications Inc. (SBC) hereby submits its Reply Comments in response to the Commission's Notice of Proposed Rulemaking seeking comment on universal service issues remanded by the United States Court of Appeals for the Tenth Circuit.

There is a fundamental disagreement in this proceeding about whether the Commission can demonstrate that the status quo is consistent with the statutory requirements of section 254 or whether significant reforms are needed to preserve and advance universal service. SBC and others persuasively demonstrate that the latter approach is compelled by the Tenth Circuit's decision and the plain language of section 254. In order to comply with the court's mandate and the requirements of section 254, the Commission should eliminate implicit subsidies and establish an integrated federal-state universal service mechanism that provides comparable treatment to rural and non-rural carriers.

The Commission has the authority, but also the obligation, to implement a national plan for universal service. Section 254 significantly expands the Commission's authority over universal service issues and imposes many requirements directly on the states. The Tenth Circuit held that the Commission has an obligation to ensure that states take the necessary action to achieve the universal service requirements of section 254 and must "develop mechanisms to induce adequate state action" to implement the statutory goals of universal service. Accordingly, the Commission should establish an integrated universal service mechanism that is binding at both the federal and state levels.

As SBC previously discussed, the Commission cannot reasonably assess whether its universal service mechanism satisfies the statutory requirements of section 254 until *after* it establishes an integrated universal service mechanism that includes the necessary state

inducements and agreements. The Commission's piecemeal approach to universal service reform precludes any determination as to the reasonableness and sufficiency of the high-cost fund at this time. SBC has proposed that the Commission establish an affordability-based universal service mechanism that strikes a reasonable balance among the various requirements of section 254. Giving meaning to the "affordability" requirement of section 254 as part of universal service reform in the manner proposed by SBC will ensure that the other requirements of section 254 are satisfied.

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SBC Communications Inc. (SBC) hereby submits its Reply Comments in response to the Commission’s Notice of Proposed Rulemaking seeking comment on universal service issues remanded by the United States Court of Appeals for the Tenth Circuit.<sup>1</sup>

Commenters express a wide range of views regarding the scope of this proceeding and the issues remanded by the Tenth Circuit. A number of commenters agree with SBC that this proceeding provides an “unprecedented opportunity” for the Commission to eliminate the outdated system of implicit subsidies and implement significant reforms of federal and state universal service mechanism.<sup>2</sup> In order to comply with the Tenth Circuit’s mandate and the requirements of section 254, the Commission must do much more than simply defend its reverse-engineered 135 percent benchmark model, compare rural and urban prices, and encourage the states to implement universal service reforms. It must establish an integrated federal-state

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<sup>1</sup> *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Notice of Proposed Rulemaking and Order, 17 FCC Rcd 2999 (2002) (*NPRM*).

<sup>2</sup> Qwest Comments at 6; General Communications, Inc. (GCI) Comments at 2; Competitive Universal Service Coalition (CUSC) Comments at 2-3.

universal service mechanism that is consistent with the Act and sustainable in a competitive environment.<sup>3</sup>

Some commenters, like AT&T, take the position that the Tenth Circuit's remand is "very narrow" and merely requires the Commission to provide additional support for its existing universal service funding mechanism.<sup>4</sup> This position cannot be squared with the court's finding that the Commission's implementation of universal service is incomplete and could not even be reviewed in relation to the statutory requirements of section 254. The Commission cannot reasonably determine that the federal universal service mechanism complies with the requirements of section 254, given the system of implicit subsidies and below-cost prices for residential local telephone service that continues to exist in the states. Only *after* the Commission establishes an integrated federal-state universal service mechanism will it be in a position to assess whether statutory requirements such as affordability, sufficiency and reasonable comparability have been satisfied.

**I. The Commission Should Conduct a Comprehensive Reform Proceeding to Eliminate Implicit Subsidies and Establish an Explicit Universal Service Mechanism**

There is a fundamental disagreement in this proceeding about whether the Commission can demonstrate that the status quo is consistent with the statutory requirements of section 254 or whether significant reforms are needed to preserve and advance universal service. SBC and others persuasively demonstrate that the latter approach is compelled by the Tenth Circuit's decision and the plain language of section 254.<sup>5</sup> In order to comply with the court's mandate and

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<sup>3</sup> See *Qwest v. FCC*, 258 F.3d 1191, 1205 (10<sup>th</sup> Cir. 2001).

<sup>4</sup> AT&T Comments at 2.

<sup>5</sup> Qwest Comments at 20-24; GCI Comments at 7-11; CUSC Comments at 7-8.

the requirements of section 254, the Commission should eliminate implicit subsidies and establish an integrated federal-state universal service mechanism that provides comparable treatment to rural and non-rural carriers.

Section 254 clearly is a mandate for change. It is not a codification of longstanding federal and state policies that have relied on implicit subsidies as the primary source of universal service support. Congress recognized the potential tension between the policy goals of local competition and universal service, and therefore it adopted section 254 as part of the 1996 Act to ensure the preservation and advancement of universal service in the new competitive environment. Yet federal and state regulators have done very little to end reliance on implicit subsidies and implement pricing structures and explicit universal service mechanisms that are sustainable in a competitive market. Therefore, as discussed further below, it is a meaningless exercise to consider key statutory requirements of section 254, such as sufficiency, reasonable comparability and affordability, only in the narrow context of the Commission's federal universal service mechanism. Although the Commission took that approach originally, the Tenth Circuit has sent a clear message that the Commission must develop and implement a comprehensive national plan for universal service that is consistent with section 254.

In its initial comments, SBC proposed that the Commission implement a three-step approach to universal service reform that integrates federal and state universal service support mechanisms in a manner that is consistent with the Act and sustainable in a competitive environment. First, the Commission should establish an affordability benchmark based on the median household income of a particular geographic area (*e.g.*, a county). Second, the Commission should establish an integrated universal service mechanism that provides funding for geographic areas where the forward-looking cost of providing service exceeds the

affordability benchmark. Third, the Commission should establish a transition plan that allows residential local prices to rise to levels that are self-supporting and affordable. This approach will ensure that residential local prices are “just, reasonable and affordable” and “reasonably comparable” between rural and urban areas, while also producing a universal service support mechanism that is “specific, predictable and sufficient.” It also will facilitate intercarrier compensation reform and remove barriers to competition in the residential local market.

A number of commenters agree with SBC that the Commission must address the problem of implicit subsidies.<sup>6</sup> As the Commission itself has acknowledged, implicit universal service support mechanisms are not sustainable in a competitive environment because they will be eroded.<sup>7</sup> Qwest correctly notes that business customers presented with a choice of carriers will not willingly pay an incumbent LEC above-cost prices that are used to subsidize below-cost prices for residential local services.<sup>8</sup> Continued reliance on implicit universal service support also impedes the implementation of intercarrier compensation reform and creates “obvious disincentives” for the development of facilities-based competition in many areas.<sup>9</sup> In addition, GCI makes the point that “non-cost-causative” prices are not competitively neutral and do not result in an “equitable and nondiscriminatory” means of assessing universal service contributions, as required by section 254(d).<sup>10</sup>

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<sup>6</sup> Qwest Comments at 20-24; GCI Comments at 7-11; CUSC Comments at 22.

<sup>7</sup> GCI Comments at 8-9.

<sup>8</sup> Qwest Comments at 21.

<sup>9</sup> *Id.*, at 22.

<sup>10</sup> GCI Comments at 9.



Despite overwhelming evidence to the contrary, AT&T attempts to argue that there is no implicit subsidy problem. It argues that because “pressure from competition is currently weak and unlikely to have any material impact on whatever implicit subsidies (e.g., rate averaging) on which the states may be currently relying, the Commission can fashion federal support based on that reality.”<sup>11</sup> Notably, AT&T has taken a very different position in state proceedings where it is seeking to reduce intrastate access charges and establish state universal service funds that are supported almost entirely by incumbent LECs. In Missouri, for example, AT&T filed testimony arguing that implicit subsidies in intrastate access charges must be replaced with an explicit universal service fund “because the current system is not sustainable in a competitive market, and it does not have everyone contributing to universal service on [an] equitable and non-discriminatory basis.”<sup>12</sup> AT&T also conceded that implicit subsidies impede competition for high-cost customers “because competitors are unable and willing to compete against artificially low local rates.”<sup>13</sup> Thus, AT&T has been much more candid about the problem of implicit subsidies when it knows someone else will be footing the bill for universal service support.

SBC shares the concern expressed by AT&T and others about not providing excessive universal service funding.<sup>14</sup> But such concerns do not justify ignoring the problem of implicit subsidies. Rather, the Commission should allow residential local prices to rise to levels that are self-supporting and affordable, and establish an integrated federal-state universal service mechanism that provides funding for geographic areas where the forward-looking cost of

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<sup>11</sup> AT&T Comments at 10.

<sup>12</sup> Affidavit of R. Matthew Kohly, filed in Missouri Case No. TO-98-329, at 5 (Aug. 15, 2001)

<sup>13</sup> *Id.*, at 7.

<sup>14</sup> *See, e.g.*, AT&T Comments at 8; Verizon Comments at 3.

providing service exceeds an affordability benchmark. The combination of end-user pricing reform and an affordability-based universal service mechanism will ensure that the universal service fund will not grow to excessive levels and will target support where it is needed.

In addition to being integrated at the federal and state levels, the universal service mechanism established by the Commission must provide comparable treatment to rural and non-rural carriers. SBC agrees with CUSC that the Commission cannot continue to limit non-rural ILECs to receiving support only for the forward-looking cost of providing service while, at the same time, allowing rural ILECs to recover their actual embedded costs.<sup>15</sup> The purpose of the universal service mechanism is to provide support that is sufficient to maintain affordable prices in rural and high-cost areas, not to allocate support based on arbitrary categories of carriers.

## **II. The Commission Has Broad Authority Under Section 254 to Implement an Integrated Federal-State Universal Service Mechanism**

The Commission has the authority, but also the obligation, to implement a national plan for universal service. Section 254 significantly expands the Commission's authority over universal service issues and imposes many requirements directly on the states. Indeed, the Tenth Circuit held that the Commission has an obligation to ensure that states take the necessary action to achieve the universal service requirements of section 254 and must "develop mechanisms to induce adequate state action" to implement the statutory goals of universal service.<sup>16</sup> The court mentioned several such inducements — the creation of a "carrot" or a "stick," or a binding cooperative agreement between the Commission and the states — in its decision.

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<sup>15</sup> CUSC Comments at 26-27.

<sup>16</sup> *Qwest v. FCC*, 258 F.3d at 1204.

A number of commenters propose using the availability of federal universal service funding as a “carrot” to induce state action to eliminate implicit subsidies and establish explicit universal service support mechanisms.<sup>17</sup> SBC doubts that such an inducement would be effective, given that states are not the recipients of federal universal service funding. A state could still force incumbent LECs to support below-cost residential local prices with implicit subsidies, even if it meant foregoing federal universal service support. If anything, experience has shown that compliance with the statutory requirements of section 254 cannot be achieved through a purely voluntary process.

In order to comply with the Tenth Circuit’s mandate and the requirements of section 254, the Commission should establish an integrated universal service mechanism that is binding at both the federal and state levels. As GCI indicates in its comments, providing universal service support through implicit subsidies from intrastate prices is not a “specific, predictable, and sufficient” universal service mechanism, as required by sections 254(d), (e) and (f) of the Act.<sup>18</sup> Moreover, requiring incumbent LECs to maintain pricing structures that generate the necessary revenue flow to support below-cost residential local prices is not an “equitable and nondiscriminatory” means of assessing universal service contributions, as required by section 254(d).<sup>19</sup> A number of commenters agrees with SBC’s position that, as with other provisions of the 1996 Act, the Commission should exercise its authority under section 254 to ensure that

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<sup>17</sup> BellSouth Comments at 4-5; Qwest Comments at 23-24;

<sup>18</sup> GCI Comments at 8.

<sup>19</sup> *Id.*, at 9.

states end their reliance on implicit subsidies and participate in a comprehensive national plan for universal service.<sup>20</sup>

### **III. The Commission Should Ensure That Its National Universal Service Plan Strikes a Reasonable Balance Among the Statutory Requirements of Section 254**

Many commenters focus on the issue of whether the Commission's 135 percent benchmark provides "sufficient" universal service support and produces "reasonably comparable" prices in rural and urban areas, as required by section 254. However, as previously discussed, the Commission cannot reasonably assess whether its universal service mechanism satisfies the statutory requirements of section 254 until *after* it establishes an integrated universal service mechanism that includes the necessary state inducements and agreements. The Commission's piecemeal approach to universal service reform precludes any determination as to the reasonableness and sufficiency of the high-cost fund at this time.

The Tenth Circuit recognized as much in its decision. It held that, in order for the Commission to "take credit" for the states' actions to achieve the statutory goals of universal service, it must assume responsibility for ensuring that the states act.<sup>21</sup> It also recognized that, even at the federal level, the universal service mechanism adopted in the *Ninth Universal Service Order* does not include rural carriers or address implicit universal service support.<sup>22</sup> Not surprisingly, the Tenth Circuit expects the Commission to fill in the missing pieces of the puzzle on remand:

At this stage . . . we do not know the full extent of federal support for universal service. This makes our task of reviewing the sufficiency of the FCC's actions

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<sup>20</sup> *Id.*, at 11; CUSC Comments at 5-6.

<sup>21</sup> *Qwest v. FCC*, 258 F.3d at 1203.

<sup>22</sup> *Id.*, at 1204-05.

considerably more difficult. At the very least, we cannot say that the FCC has shown that it is providing sufficient support for universal service. On remand, the FCC will have an opportunity to explain further its *complete plan for supporting universal service*.<sup>23</sup>

Thus, the Commission must do much more than simply provide a more detailed explanation for its reverse-engineered 135 percent benchmark and compare rural and urban prices under the current system of implicit subsidies.

As part of its complete plan for universal service, SBC proposed that the Commission establish an affordability-based universal service mechanism that strikes a reasonable balance among the various requirements of section 254. Giving meaning to the “affordability” requirement of section 254 as part of universal service reform in the manner proposed by SBC will ensure that the other requirements of section 254 are satisfied. An affordability benchmark gives meaning and context to the “sufficiency” requirement of section 254. By establishing an affordability benchmark for a geographic area, such as a county, the Commission will be able to provide targeted universal service support where it is needed. At the same time, the combination of end-user pricing reform and an affordability benchmark will ensure that the amount of universal service funding is not excessive and beyond what is necessary to achieve the goals of the Act.<sup>24</sup>

Moreover, affordability provides a rational basis for assessing whether prices in urban areas are reasonably comparable to rural areas. Focusing exclusively on the percentage variation of prices across the country may reveal whether prices are “comparable,” but does not provide any information about whether prices are “reasonably comparable.” As SBC previously

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<sup>23</sup> *Id.*, at 1205 (emphasis added).

<sup>24</sup> *See* GCI Comments at 6.

discussed, this comparison is particularly meaningless when the prices being compared are all below cost and being subsidized by other services and customers. Instead, the Commission should determine that prices in urban and rural areas are reasonably comparable if they are based on a common affordability standard.

Contrary to the suggestion of some commenters, it is inappropriate to consider the “local calling area” or the “value of service” when assessing the reasonable comparability of urban and rural prices.<sup>25</sup> The argument that rural local telephone service is less valuable because a rural subscriber may have access to fewer subscribers within the local service area ignores the fact that rural subscribers derive many benefits from living in areas where there are fewer people in close proximity. Indeed, that is precisely why many people choose to live in those areas. In addition, the argument that rural telephone service should be subsidized to the point that it is priced lower than urban service erroneously assumes that rural subscribers have the same calling patterns as urban subscribers and that rural subscribers have an entitlement to reach the same number of people with a local telephone call. Moreover, these “value of service” arguments would impose an unnecessary burden on the universal service system. Subscribers in low-cost urban areas already subsidize the higher cost of providing telephone service in rural areas and should not be forced to bear the additional burden of making local telephone service cheaper in rural areas than it is in urban areas.

GCI identifies yet an additional reason for establishing an affordability benchmark in its comments — it provides a demarcation point for assessing whether a state’s pricing policies are

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<sup>25</sup> Consumer Advocates Comments at 5; Missouri Public Counsel Comments at 4. SBC notes that most of the additional costs that rural subscribers incur when making calls outside their local area are the result of state policies that inflate intrastate access charges with implicit universal service support.

consistent with the Commission comprehensive national plan for universal service. A state should not be permitted to set prices below levels that are affordable in order to increase the amount of universal service support received from the federal mechanism. This would violate section 254(f), which precludes a state from “rely[ing] on or burden[ing] Federal universal service support mechanisms.”<sup>26</sup>

#### **IV. Conclusion**

For these reasons, the Commission should respond to the Tenth Circuit’s remand decision by implementing an integrated federal-state universal service mechanism. This mechanism should include rationalized local prices and an affordability-based universal service mechanism.

Respectfully submitted,

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<sup>26</sup> GCI Comments at 7.

## CERTIFICATE OF SERVICE

I, Daniel Wang, certify that a copy of the foregoing Reply Comments of SBC Communications Inc. was served on the parties below via USPS First Class Mail, postage pre-paid, on this 25<sup>th</sup> day of April 2002.

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